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IN THE
Supreme Court of the United States

OCTOBER TERM, 1948

No. 194

CENTRAL INVESTMENT CORPORATION, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States
Court of Appeals for the Ninth Circuit

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 46-59) is reported at 9 T. C. 128. The opinion of the Circuit Court of Appeals (R. 94) is reported at 167 F. 2d 1000.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on May 7, 1948. (R. 95). The petition for a writ of certiorari was filed on August 4,

1948. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTION PRESENTED

Did the courts below err in holding that the California franchise tax imposed and paid in 1944 for the privilege of doing business for the year 1944 but measured by income realized in 1943 is not accruable and deductible for federal tax purposes in the year 1943, under Section 23(c)(1) of the Internal Revenue Code, in the case of a taxpayer on the calendar year and accrual basis of accounting?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set out in the Appendix, *infra*.

STATEMENT

The facts found by the Tax Court may be summarized as follows:

The taxpayer is a California corporation, organized October 6, 1921, with its principal offices located in Los Angeles, where it owns the Biltmore Hotel. At no time material hereto did the taxpayer have any pending negotiations for the sale of its Biltmore Hotel property or contemplate dissolution or liquidation. (R. 47.)

A California franchise tax act was enacted as the Bank and Corporation Franchise Tax Act, c. 13, Laws of 1929. This Act as amended in 1943 pro-

vides in Section 4 (3) that corporations doing business in California "shall annually pay to the State, for the privilege of exercising its corporate franchises * * *, a tax according to or measured by its net income, to be computed, in the manner hereinafter provided, at the rate of 4 per centum upon the basis of its net income for the next preceding fiscal or calendar year." (R. 47-48.) Section 11 defines "income year" and "taxable year", Section 4 (7) provides that taxes under this section shall accrue on the last day of the income year, and Section 29 (a) provides that the taxes shall constitute a lien upon the real property of the taxpayer and shall attach on the last day of the income year. (R. 48-49.)

Prior to the 1943 amendment, the Act provided that the tax accrued and the lien thereto attached on the first day of the taxable year. (R. 49.)

Taxpayer filed on April 26, 1943, for the privilege of doing business within the State during the calendar year 1943 its franchise tax return which disclosed its gross and net incomes for the calendar year 1942 and a franchise tax liability of \$19,736.60, which was paid in April and September, 1943. The taxpayer filed on May 5, 1944, for the privilege of doing business within the State for the calendar year 1944, its franchise tax return which disclosed its gross and net incomes for the calendar year 1943 and a franchise tax liability of \$43,174.36. (R. 50-51.)

The franchise tax for 1944 was imposed by Section 4 (3) of the Act and was determined "according to or measured by" the net income for the calendar year 1943 of \$1,206,923.17. The tax of \$43,174.36 was set up on the taxpayer's books of account as a liability as of December 31, 1943, before the closing of the books for the calendar year 1943, and was paid in March and September, 1944. Taxpayer has never disputed its liability for the whole or any part of the tax, has never filed any claim for refund or credit for the whole or any part thereof, and has never had, and does not now have, any intention of filing any such claim. (R. 51.)

In filing its federal income and excess profits tax returns for the calendar year 1943, the taxpayer claimed deductions not only for the California franchise tax imposed for the privilege of doing business in the State during 1943, in the amount of \$19,736.60, but also for the California franchise tax imposed for the privilege of doing business in the State during 1944, in the amount of \$43,174.36. (R. 51.)

The Commissioner disallowed the deduction of \$43,174.36 for the calendar year 1943 on the ground that the franchise tax paid for the year 1944 was properly accruable and deductible for federal income tax purposes in the calendar year 1944 under Section 23 (c) of the Internal Revenue Code. (R. 51-52.)

The Tax Court sustained that action (R. 46), and the Circuit Court of Appeals in a *per curiam* opinion simply pointed out that the findings of fact had not been challenged, and that it agreed with the conclusions stated in the Tax Court's opinion. (R. 94.)

ARGUMENT

The decision below is in accordance with, and required, by the settled principles governing deductions for accrued taxes: (1) The obligation to pay the tax must have been "incurred" within the taxable year, i.e., the tax must be imposed for the taxable year in which the deduction is taken; (2) all the events giving rise to and therefore creating a fixed and definite liability for payment must occur in the taxable year. *United States v. Anderson*, 269 U. S. 422. Cf. *Security Mills Co. v. Commissioner*, 321 U. S. 281, 284, 286-287; *Dixie Pine Co. v. Commissioner*, 320 U. S. 516, 519; *Brown v. Helvering*, 291 U. S. 193; *Fawcus Machine Co. v. United States*, 282 U. S. 375; *Aluminum Castings Co. v. Routzahn*, 282 U. S. 92, 99; *Niles Bement Pond Co. v. United States*, 281 U. S. 357; *American National Co. v. United States*, 274 U. S. 99, 103, 105. Here, taxpayer, which was allowed as a deduction from 1943 income the 1943 California franchise tax, seeks also to deduct the 1944 franchise tax, based on amendments to the California Bank and Corporation Franchise Tax Act contained in Sections 4 (7) and 29 (Appendix, *infra*)

changing the accrual and lien dates (in the case of 1944 and later taxes) from January 1, 1944, to December 31, 1943. But the controlling fact under the decisions of this Court, unaffected by these amendments, is that the 1944 tax was imposed for doing business in 1944 (California Bank and Corporation Franchise Tax Act, Section 4 (3) (Appendix, *infra*), and that as of December 31, 1943, there was no liability for the tax (R. 29). California Bank and Corporation Franchise Tax Act, Sections 4 (3) and (5), 11 (a) and (b), 13 (k) (Appendix, *infra*). On the merits, therefore, the courts below were correct in holding that the 1944 tax could not be an accrued deduction for 1943.

The petition asserts, as reasons for granting the writ, that the decision below if undisturbed will control the tax liability of numerous other corporations doing business in California (Pet. 5-6), and that the decision is in conflict with eight other decisions¹ (Pet. 6-11).

The short answer to these contentions is that the controlling principles in this type of case have already been settled by this Court, and were adhered to by the courts below in this case; and there is no conflict of decisions. The Tax Court correctly based its decision on *United States v. Anderson, supra*

¹ *United States v. Anderson, supra*; *Magruder v. Supplee*, 316 U. S. 394; *Dixie Pine Co. v. Commissioner, supra*; *Security Mills Co. v. Commissioner, supra*; *Commissioner v. Le Roy*, 152 F. 2d 936 (C. C. A. 2d); *Helvering v. Russian Finance & Construction Corp.*, 77 F. 2d 324 (C. C. A. 2d); *San Diego v. Riverside*, 125 Cal. 495; *East Bay Municipal U. Dist. v. Garrison*, 191 Cal. 680.

(R. 56-57); and *Dixie Pine Co. v. Commissioner*, *supra*, and *Security Mills Co. v. Commissioner*, *supra*, provide further support for the result below. The question for decision in *Magruder v. Supplee*, 316 U. S. 394, was whether certain payments constituted taxes "paid" within the taxable year; as the Courts of Appeals for the Third and Fifth Circuits have expressly noted, no accrual issue was involved in that case. *Allen v. Atlanta Stove Works*, 138 F. 2d 452 (C. C. A. 5th); *Commissioner v. Schock, Gusmer & Co.*, 137 F. 2d 750 (C. C. A. 3d). *Commissioner v. Le Roy*, 152 F. 2d 936 (C. C. A. 2d), dealt with the same issue involved in *Magruder v. Supplee*, *supra*. In *Helvering v. Russian Finance & Construction Corp.*, 77 F. 2d 324 (C. C. A. 2d), the court applied the doctrine of *United States v. Anderson*, emphasizing the requirement of fixed liability in order to accrue an expense. Its conclusion that the discharge by a condition subsequent of a present liability did not defeat the accrual is not inconsistent with the result here, because there was on December 31, 1943, no liability for the 1944 tax.

Finally, the reliance on conflict with *San Diego v. Riverside*, 125 Cal. 495, and *East Bay Municipal U. Dist. v. Garrison*, 191 Cal. 680, is misplaced. The latter case merely throws doubt on the validity of Section 29, California Bank and Corporation Franchise Tax Act, in that it held that a lien where there is no liability is unconstitutional; but this has no relevance to the issue at bar. Clearly, neither case

undermines the conclusion below, based on the unambiguous provision of the California Bank and Corporation Franchise Tax Act, that at no time in the taxable year was there any liability for the 1944 franchise tax.

CONCLUSION

The decision below is correct. There is no conflict of decisions. The petition for certiorari should be denied.

Respectfully submitted,

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September 1948

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) [as amended by Section 202 (a) of the Revenue Act of 1941, c. 412, 55 Stat. 687] *Taxes Generally.*—

(1) *Allowance in General.*—Taxes paid or accrued within the taxable year,

* * * * *

(26 U. S. C. 23.)

Part IV—Accounting Periods and Methods of Accounting

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the

net income shall be computed on the basis of the calendar year.

(26 U. S. C. 41.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

(26 U. S. C. 43.)

SEC. 48. DEFINITIONS.

When used in this chapter—

* * * * *

(c) "*Paid or Incurred*," "*Paid or Accrued*".—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * * * *

(26 U. S. C. 48.)

California Bank and Corporation Franchise Tax Act (3 Deering, California General Laws, 1945 Pocket Supp., Act 8488):

§ 4. *Corporations subject to tax: Tax measurement and computation: Offsets: Exempt corporations.*

* * * *

(3) [*Other corporations doing business in state: Measurement and computation of tax: Minimum.*].—With the exception of financial corporations, every corporation doing business within the limits of this State and not expressly exempted from taxation by the provisions of the Constitution of this State or by this act, shall annually pay to the State, for the privilege of exercising its corporate franchises within this State, a tax according to or measured by its net income, to be computed, in the manner hereinafter provided, at the rate of 4 per centum upon the basis of its net income for the next preceding fiscal or calendar year. In any event, each such corporation shall pay annually to the State, for the said privilege, a minimum tax of twenty-five dollars (\$25).

* * * *

(5) [*Corporations not otherwise taxed: Amount of tax.*].—Every corporation not otherwise taxed in pursuance of this section and not expressly exempted by the provisions of this act or the Constitution of this State shall pay annually to the State a tax of twenty-five dollars (\$25).

* * * *

(7) [*When taxes accrue.*].—Taxes under this section and under Sections 1 and 2 of this act shall accrue on the last day of the "income year," as defined in Section 11 hereof.

* * * *

§ 11. *Definitions.*—(a) The term “*income year*,” as herein used, means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed herein. “*Income year*” means, in the case of a return made for a fractional part of a year, the period for which such return is made.

(b) The term “*taxable year*,” as herein used, means the calendar year, or the fiscal year ending during such calendar year, for which the tax is payable. A “*taxable year*” may constitute a period of 12 months or of less duration.

* * * * *

(d) The terms “*paid or incurred*” and “*paid or accrued*” shall be construed according to the method of accounting upon the basis of which the net income is computed hereunder.

* * * * *

§ 13. *Returns. Prepayment of taxes, etc.*

(a) [*Returns.*]—Every bank and corporation subject to the tax imposed by this act shall, within two months and 15 days after the close of its income year, transmit to the commissioner a return in a form prescribed by him, specifying for the income year, all such facts as he may by rule, or otherwise, require in order to carry out the provisions of this act. * * *

* * * * *

(b) [*Prepayment of minimum taxes.*—A corporation which incorporates or organizes under the laws of this State or qualifies to do business in this State, after the effective date of this act, shall thereupon prepay the minimum tax hereunder, which prepayment must be made before the corporation files with the Secretary of State its articles of incorporation or duly certified copy thereof as the case may be.

* * * * *

(k) [*Dissolved or withdrawn banks or corporations.*—(1) Any bank or corporation which is dissolved and any foreign corporation which withdraws from the State during any taxable year shall pay a tax hereunder only for the months of such taxable year which precede the effective date of such dissolution or withdrawal, according to or measured by (A) the net income of the preceding income year or (B) a percentage of such net income determined by ascertaining the ratio which the months of the taxable year, preceding the effective date of dissolution or withdrawal, bears to the months of such income year, whichever is the lesser amount; * * * In any event, each such corporation shall pay a tax not subject to offset for such period in an amount equal to the minimum tax provided for in Section 4 of this act.

* * * * *

§ 23. *Time for payment of taxes: Extension of time: Payment to commissioner: Deposit of moneys received.* * * *

* * * * *

In the case of corporations of the classes referred to in Subdivision (3) of Section 4 of this act, one-half the amount of tax disclosed by the return shall be due and payable as a first installment of the tax on such corporations on or before the fifteenth day of the third month following the close of the income year, as defined in Section 11 hereof. The balance of the tax shall be due and payable as a second installment on or before the fifteenth day of the ninth month following the close of the income year. A tax imposed by this act or any installment thereof may be paid at the election of the taxpayer, prior to the date prescribed for its payment.

* * * * *

§ 29. *Tax lien: Certificate of satisfaction.*

[*Taxes constitute lien: Effect, etc.*].—The taxes imposed by this act and disclosed on the return shall constitute a lien upon the real property of the taxpayer, which lien shall have the same force, effect and priority as a judgment lien and shall attach on the last day of the "income year," * * *. The taxes imposed by this act and determined pursuant to Sections 16, 25 or 28 shall constitute a lien upon all real property of the taxpayer located in any county in which there is filed for record in the office of the county recorder a certificate executed by the commissioner stating that payment of a tax determined under the provisions of Sections 16, 25 or 28 of this act has been demanded and has not been paid and specifying the amount thereof and the name

of the taxpayer, and such lien shall attach at the time the certificate is recorded and shall have the same force, effect and priority as a judgment lien. The lien provided for in this section shall remain until the taxes are paid or the property subject to the lien is sold for the payment thereof, or until the lien is released or otherwise extinguished. * * *

* * * * *

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23 (c)-1. *Taxes.*—(a) *In general.*—Subject to the exceptions stated in this section and sections 29.23 (c)-2 and 29.23 (c)-3, taxes imposed by the United States, any State or Territory, or political subdivision of either, possessions of the United States, or foreign countries, are deductible from gross income for the year in which paid or accrued (see section 43). * * *

SEC. 29.41-1. *Computation of net income.*—* * * The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayers' income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See sections 29.42-1 to 29.42-3, inclusive.) If the taxpayer does not regularly

employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

SEC. 29.41-2. *Bases of computation and changes in accounting methods.*—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 48 for definitions of “paid or accrued” and “paid or incurred.” All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. * * *

SEC. 29.41-3. *Methods of accounting.*—It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. * * *

SEC. 29.43-1. *“Paid or incurred” and “paid or accrued.”*—(a) The terms “paid or incurred” and “paid or accrued” will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. (See section 48 (c).) The deductions and credits provided for in

chapter 1 (other than the dividends paid credit provided in section 27) must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. * * *

SEC. 29.43-2. *When charges deductible.*— Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses, liabilities, or deficit of one year cannot be used to reduce the income of a subsequent year. A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he cannot deduct them from the income of the next or any succeeding year. * * *